No. 10233

IN THE

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE NINTH CIRCUIT

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THOR W. HENRICKSEN, Acting Collector of Internal Revenue, *Appellant*,

vs.

W BRAICKS and J. G. MOLZ, Liquidating Trustees of Pommerelle Company, Inc., a Corporation, *Appellees*.

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION
HONORABLE LEWIS B. SCHWELLENBACH, *Judge*

BRIEF OF APPELLEES

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STATEMENT

In order to properly evaluate appellant's position and argument upon this appeal, it is necessary to know something more than is contained in his statement about the background and history of the case in the lower court. While not entirely obvious, a study of the record, particularly the commissioner's assessment letter and the trial court's decision, together with admissions in the appellant's brief, discloses that the controversy now presents quite a different aspect from that decided by the trial court. The case arose in this way:

The taxpayer, Pommerelle Company, Inc. (which we shall hereafter call the old company) claimed a

dividend paid credit upon its tax return for 1937, on account of a distribution in liquidation under Sec. 27 (f) I.R.C. The commissioner disallowed the credit, and assessed the additional tax involved in this proceeding on the ground that the distribution was a non-taxable dividend and therefore not an allowable credit. This holding was based upon the theory that the stock in the Pommerelle Company (which we shall hereafter call the new company) was issued to the stockholders of the old company in connection with a transaction coming under the provisions of Sec. 112 (b) of the Revenue Act of 1936, dealing with tax deferred exchanges, and was not taxable to them, and that therefore the transaction came within Sec. 27 (h), disallowing a credit for a nontaxable distribution, which it was held took precedence over Sec. 27 (f) allowing a credit for a distribution in liquidation.

In support of the action in the trial court appellees made two claims:

First, that Sec. 27 (f) should be applied in preference to Sec. 27(h), relying upon the interpretation placed upon such section by the Circuit Courts of Appeals of the 2nd Circuit in *Comm. v. Kay Mfg. Corp.*, 122 F.(2d) 442, 1941-2 U.S.T.C. §9635 and the 4th Circuit in *Helvering v. Credit Alliance Corp.*, 122 F. (2d) 361, 1941-2 U.S.T.C. §9639 and by the Board of Tax Appeals in a large number of similar cases, as opposed to the commissioner's theory which was supported by the opinion of the Circuit Court of Appeals of the 5th Circuit in the case of *Centennial Oil Co. v. Thomas*, 109 F.(2d) 359, 40-1 U.S.T.C. §9197. Secondly, appellees urged that even if their first contention

was incorrect, the commissioner was still wrong in classifying the transaction as a nontaxable distribution or exchange.

The trial court held with the appellees upon both of their contentions. It was his opinion and holding that the old company liquidated by turning over its assets to designated trustees, who, by arrangement with the stockholders, held and dealt with such assets as trustees for the individual stockholders; that proportionate undivided interests in liquidation were assigned and set over to the stockholders, each of whom was then free to deal with his interest as he saw fit; and that thereafter the stockholders converted their undivided interests in the property into shares of the new corporation for which they had previously subscribed; that all parties recognized the freedom of the stockholders to go into or stay out of the new company and that it did not constitute a tax free reorganization or transaction (R. 24 to 29). In addition, the court held that even if this conclusion was wrong, there was nevertheless a distribution in liquidation under the provisions of Sec. 27 (f) of the Revenue Act of 1936, which should be applied, rather than the provisions of 27 (h), and that the company was entitled to the credit in any event under the provisions of that section (R. 30 to 34).

Appellant's statement of points and outline of argument upon this appeal (App. Br. 13, 15) are directed entirely toward the contention that the old company did not distribute its physical assets to its stockholders, but acting through the trustees in liquidation assigned them to the new company, which in

return issued its stock to the stockholders of the old. Presumably, although he does not specifically claim it, he considers this a transaction coming within the provisions of 112 (b). His argument is solely an effort to refute the court's holding that there was a distribution by the old company of the physical assets to its stockholders. But this is only a part of the picture, and it fails to recognize that even if appellant were right in his contention as to the transfer of the assets, there was still a distribution in liquidation, giving rise to dividend credit. It is undeniable that a liquidation of the old company did occur (App. Br. p. 8). It began with the adoption of the resolution and it ended not later, in any event, than the receipt by the stockholders of stock in the new company. We maintain and the court found that the liquidation occurred by transfer of the physical assets to the stockholders, acting through the liquidating trustees, who then used their undivided shares to pay for their stock in the new company. Appellant contends, on the other hand, that the old company acting through the liquidating trustees transferred its assets to the new company, thereby becoming, in effect, a stockholder of the new company, but causing the stock to be issued directly to the individual shareholders.

Either way, there was a liquidation of the old company, and the allowance of the dividend credit does not depend simply on whether the course followed was that claimed by the appellees and found by the trial court or was as contended by the appellant. Even if viewed as appellant contends, the dividend credit would still be allowable under Sec. 27(f). The appellant wholly ignores this phase of the matter.

ARGUMENT

EVEN IF THE TRANSACTION IS REGARDED, AS APPELLANT CONTENDS, AS A TRANSFER OF ASSETS DIRECTLY TO THE NEW COMPANY, THERE WAS STILL A LIQUIDATION OF THE OLD COMPANY, ENTITLING IT TO A DIVIDEND PAID CREDIT.

For the sake of the argument on this point, we shall accept appellant's contention that the trustees did not represent the stockholders and that in effect the physical assets passed directly from the old company to the new one. If that was true, then that transaction in itself was not a liquidation but an exchange, which, we will assume, was nontaxable under Sec. 112 (b) (4) I.R.C. The old company then became entitled to the stock of the new. This stock, however, it caused to be issued directly to the individual stockholders, and this action effected the liquidation which had previously been authorized. If we accept appellant's contention, then instead of a distribution of undivided interests in physical assets in kind, the liquidation was accomplished by a distribution of the stock of the new company. Since Sec. 27 (f), allowing a dividend credit for amounts distributed in liquidation, controls over Sec. 27 (h), it is immaterial whether the liquidation was accomplished in the manner found by the court or in the manner found by the appellees. It occurred in one way or the other and whichever way it was, the credit would be allowable just the same.

At the time the case was submitted to the lower court the question of application of Sec. 27 (f) was a debatable one and appellant strenuously maintained

that, in view of the provisions of 27 (h), no credit would be allowed if the distribution was in connection with a nontaxable exchange. On April 27, 1942, however, the Supreme Court decided *Helvering v. Credit Alliance Corp.*, 316 U.S. 107, 62 S.Ct. 989, 42-1 U.S. T.C. §9440, in which it affirmed the decision of the 4th Circuit that sub-section (f) takes precedence over sub-section (h) and allows a credit for a distribution in liquidation, regardless of whether or not there is involved a nontaxable distribution.[1]

It follows, therefore, that if the old company did make a distribution in liquidation, it was entitled to the credit under Sec. 27 (f). Even if the transfer of physical assets was made as appellant contends, direct from the old company to the new, and even if this constituted a tax free exchange (which we do not concede) such considerations are not controlling, because there followed a distribution in liquidation of the stock so received by the old company to its stockholders (accomplished by issuing such stock directly from the new company to them), and such a distribution in liquidation was a taxable transaction to the stockholders under the provisions of 115 (c) I.R.C., and they so treated it. While appellant argues that liquidation did not occur in the manner and form as found by the trial court, he does not maintain that the old company did not liquidate, and the only difference would be between distributing physical assets and

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[1]For a discussion of liquidation distributions, and citation of other court and Board cases on the subject, see 1943 C.C.H. Vol. 1, at pages 2208-11.

stock. In either case, however, it would be a distribution in liquidation and the credit was properly allowed.

THE OLD COMPANY DISTRIBUTED ITS ASSETS IN LIQUIDATION TO ITS STOCKHOLDERS WHO SUBSEQUENTLY AND WITHOUT PREVIOUS OBLIGATION EXCHANGED THEM FOR STOCK IN THE NEW COMPANY.

While we accepted appellant's version of the transaction in the foregoing discussion, feeling that it could not affect the result, we did not mean in any way to concede the correctness thereof but feel that the findings and conclusions of the trial court are amply supported by the record. Indeed, the appellant has taken no exception and assigned no error upon the court's findings of fact, either in his statement of points (R.208; App. Br. 13) or in his argument.

While it is urged that the step taken was for the purpose of lessening taxes, it is admitted that "the government has not challenged the right of the new corporation to its saving in excess-profits taxes by virtue of the larger declared value of its capital stock" (App. Br. 21), and no authority need be cited to the oft repeated statement that no condemnation attaches to the use of lawful means to minimize the burden of taxes (101 A.L.R. 204). Moreover, as the trial court pointed out, that purpose was not directed at the tax here involved, which was only incidentally affected (R.19), and the true purpose of the undistributed profits tax was recognized and effectuated in the steps taken by returning the income upon dis-

tribution to stockholders and paying the tax thereon. As the court said "it must, therefore, be realized that the transaction under inspection here fully complied with the legislative purpose for the raising of revenue and that the mechanism used in the transaction was not devised with an ulterior purpose" (R.20).

The trial court has so well covered both the factual and the legal situation and arguments in support of the appellees' position in his exhaustive opinion (R. 15-34) that little need be added except a few comments directed particularly at the argument advanced in appellant's brief.

The record shows that the old company adopted its resolution for liquidation on September 30, 1937 (R.88). On October 4, 1937, the final meeting of the stockholders was held, at which the liquidating trustees reported that they had liquidated its assets and affairs by distributing the same to its stockholders in undivided portions, and the stockholders voted unanimously to accept their proportionate shares in liquidation (R.89, 90). It is clearly apparent that all parties intended and assumed that a distribution of undivided interests to the respective stockholders was effected either by the resolution or by the action of the trustees, or both (R. 149, 150). Subsequent to this time, although on the same day, the stockholders offered to exchange their undivided ownerships and interests in such assets in payment of stock in the new corporation, for which they had previously subscribed for cash. Appellant questions the reliability of this record, claiming that this offer was dated September 30th (App. Br. 10) and arguing that it therefore

could not contain a balance sheet of October 4th (App. Br. 19). In making this criticism, the appellant has apparently misread the record containing the exhibits. Beginning at page 100 of the transcript, the date of September 28th clearly relates to the preceding oath of office and not to the subscription for stock, as claimed by appellant (Br. 9, 19). The next date, September 30, 1937, appearing at the middle of page 101, should be read as applicable to the subscription to stock of the new company. The offer to exchange property for stock is not specifically dated, but since it carries a statement of assets and liabilities, bearing date of October 4th, and since it is obviously the offer referred to on page 106 as dated October 4th, such facts would seem to establish that as its date and that the criticism is unjustified. While the trial court's findings did not specifically set forth the dates, his opinion establishes the sequence of events as being a liquidation through transfer to the liquidating trustees as agents of the stockholders, followed by the latter's offer to transfer such interests to the new company in payment for its stock (R. 15, 16).

The obvious purpose of this criticism is to impugn the record showing an interval elapsing after the distribution of the old company's assets before the surrender of them to the new company. This break in ownership, however, does not depend only on the minutes but is well supported by the testimony of several witnesses to the effect that each stockholder was advised upon the liquidation of the old company that he was free to either stay out of, or go into, the new company as he chose, and arrangements were made

to take over the interests of any of the stockholders who might prefer not to go on. This was not merely an internal understanding but involved going to the company's bankers and arranging for the necessary funds for that purpose (R. 16, 38, 54, 61, 66, 68, 70, 123, 124, 132, 143, 144, 150, 151).

It is appellant's contention that the old company continued to be the legal owner of its properties until they were turned over to the new company pursuant to the offer of the individual stockholders, so that title went directly from the old company to the new (App. Br. 16). It is urged that this was so because no formal instruments were executed conveying the assets to the stockholders (App. Br. 3, 18). That, however, would have been a cumbersome procedure, since the interests were necessarily indivisible. The trial court considered that the assets went in undivided interests to the shareholders of the old company and were held for them in trust by the trustees in liquidation (R. 15, 24, 37, 38). This, we submit, is in accord with Washington law. While there is no case directly upon the point, the statutes governing liquidation recognize that upon the adoption of the resolution the corporation itself ceases to function and the assets are subject to possession and distribution by the trustees, to be applied first to the payment of debts and then to the interests of the stockholders. The adoption of such resolution necessarily transferred to the designated trustees either the legal title to or at least possession of the property of the corporation, since the statute vests them with the power to collect amounts due, sell any and all assets and pay

the debts (Rem. Rev. Stat. §3803-52), to compromise and settle claims (§3803-54), and directs that any balance remaining after paying the corporate debts be paid over to the shareholders (§3803-52(2)). When the proceedings for dissolution are begun, the right of the corporation to function in the usual manner, and the authority and duties of the directors and officers, come to an end (§3803-56(2a)).

Remington's Revised Statutes §3836-15 provides that in the event of dissolution of any corporation for the nonpayment of fees, either by court action or otherwise, the trustees shall hold the title to the corporate property for the benefit of its creditors and stockholders. Prior to the adoption of the Uniform Business Corporation Act embodying the above section, Remington's Revised Statutes §3833 provided that the trustees at the time of the dissolution should be trustees for the creditors and stockholders of the corporation dissolved with power to divide among the stockholders the property and money remaining after payment of debts. While this section was repealed by §3803-62a, nevertheless there is nothing in the new statute which is inconsistent with the prior one to the effect that the trustees are trustees for the stockholders and it would seem that that is still a fair interpretation of the term. That this is the general rule as borne out by 16 Fletcher Cyc. Corp. (Perm. Ed.) §8195, where it is stated that upon the dissolution of the corporation, the corporate entity ceases, and the property and funds of the corporation are vested in the trustees for the stockholders. Where, for example, the trustees misappropriate corporate

funds, it is held that the remedy is one for money had and received to the use of the stockholders. *Denman v. Richardson* (W.D. Wash.) 284 F. 592, affirmed by this court, 292 Fed. 19.

Under the above statutory provisions, as well as the trust fund doctrine respecting corporate assets applicable in the state of Washington, the trustees necessarily took and held the property, first for the satisfaction of debts, and secondly for the equitable benefit of and distribution to the stockholders.

"The general effect of statutes designating or providing for the appointment of trustees for dissolved corporations is to constitute the property and rights of the dissolved corporation a trust fund to be administered by the trustees for the purposes specified by the legislature. The doctrine generally accepted with little dissent is that statutes of the kind under review vest the legal title to the corporate property in the trustees." 13 Am. Jur. Corporations §1359. See also annotations 97 A.L.R. 486; 47 A.L.R. 1528-29, 1540; Fletcher Cyc. Corp. Vol. 16 §§8174, 8195.

Indeed the Supreme Court of Washington indicates that it goes even further than that by its comment in *Cohen v. L. & G. Investment Co.*, 186 Wash. 308, referring to "the well established rule that, upon dissolution, the property of a corporation passes to the stockholders, subject to the corporate liabilities." See also *Golden Rule Trading Co.* (D.C. Wash.) 17 F. Supp. 21.

However that may be, it is well established that the trustees hold no more than a legal title in trust for the stockholders as the beneficial owners, subject only to

the debts. The recognition of the stockholders' interest by the accounting of the trustees and acceptance of the stockholders (R. 90) would seem sufficient to fix or accomplish the status of an actual distribution.

The failure to pay the debts would not prevent the distribution in liquidation as claimed by the appellant (Br. 18). The assets were dealt with subject to the liabilities (R. 102) which by the terms of the offer the new company was to assume and agree to pay, and by its acceptance of such offer it must be deemed to have assumed such obligations (R. 106). "Stockholders actually receiving the assets of their corporation on its dissolution in virtue of their stock are held to receive a present liquidating dividend though they may not pay the corporate debts and fully administer the assets until later. *Hellmich v. Hellman*, 276 U.S. 233, 48 S. Ct. 244, 72 L. ed. 544, 56 A.L.R. 379; *Jemison v. Commissioner* (C.C.A.) 45 F.(2d) 4; *Wells Fargo Bank v. Blair, supra.*" *Snead, Collector v. Elmore* (C.C.A. 5) 59 F.(2d) 312, 11 A.F.T.R. 484.

A similar situation was involved in the appeal of *Harbor Holding Company of Nevada et al.*, Memo dec. Docket Nos. 106027-106031, entered November 10, 1942, where the board said:

> "Respondent argues that petitioner had a continued existence, *de facto*, and that Henderson was acting as *its* liquidating trustee, rather than as a trustee for the former stockholders, because of the existence of unpaid liabilities. Under all of the circumstances, respondent takes the view that since petitioner's debts were not paid prior to the liquidating distribution, the Van Camp stock remained vested in petitioner after the dissolu-

> tion, through a 'liquidating trustee.' In our opinion this phase of the situation does not militate against petitioner. Under ordinary circumstances there is no impediment to a corporation's selling or distributing its assets to others in consideration for their assuming the corporation's liabilities. It is a question of fact of what is done. The existence of debts does not prevent or defer the vesting of title to assets distributed to stockholders. This was pointed out in *Snead v. Elmore*, 59 F.(2d) 312, 315. * * *
>
> "Here the stockholders actually received petitioner's assets on its dissolution. They received the assets unconditionally. A corporation may distribute its assets in complete liquidation without first paying all of its debts." (p. 35, 36)

This record, plus the information returns made in connection with the liquidation (R. 81) and the detailed statements and instructions to the stockholders regarding profit and return of income on distribution and the payment of tax thereon by the stockholders (R. 56) all indicate and support the court's finding of an actual distribution in liquidation. Such liquidation or distribution is a question of fact upon which the court has made a specific finding supported by substantial evidence which should not be disturbed.

The cases discussed by appellant at page 24 of his brief involving liquidations designed to shift income by converting a sale by the corporation into a sale by individual stockholders, present an entirely different principle and depend primarily upon the peculiar facts of each case and seem not to require comment. They are not inconsistent with the decision here. They hold

that if the distributees are obligated to complete a bargain begun by the corporation, they are acting merely as the corporation's agent. If not, and if they are free to choose between making a sale, or not, then they are acting for themselves. *Chisholm v. Comm.* 79 F. (2d) 14, 101 A.L.R. 200, cert. den. 296 U.S. 641.

Upon this phase of the case, the governing considerations are primarily of a factual nature and being supported by substantial evidence are not subject to being disturbed, particularly in the absence of any exceptions thereto.

It seems to be contended by appellant and we have assumed, without conceding, that the transfer of physical assets to the new company for which stock was issued by the latter directly to the stockholders of the old company was a nontaxable transaction under Sec. 112(b) of the Revenue Act of 1936.[2] While we think

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[2]SEC. 112 RECOGNITION OF GAIN OR LOSS. (Revenue Act of 1936.)

(b) Exchanges solely in kind.

(1) *Property held for productive use or investment.* No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

(2) *Stock for stock of same corporation.* No gain or loss shall be recognized if common stock in a corporatin is exchanged solely for common stock in the

that is immaterial, since there was a liquidation taxable under Sec. 115(c) I.R.C., nevertheless, if it is relevant, we think it is a mistaken conclusion or assumption.

Section 112(a) provides that upon the sale or ex-

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same corporation, or if preferred stock in a corporation is exchange solely for preferred stock in the same corporation.

(3) *Stock for stock on reorganization.* No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) *Same—Gain of corporation.* No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(5) *Transfer to corporation controlled by transferor.* No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

(6) *Property received by corporation on complete liquidation of another.* No gain or loss shall be recognized upon the receipt by a corporation of property distributed in complete liquidation of another corporation. * * *

change of property the gain shall be recognized except as thereinafter provided. Section (b) deals with "exchanges solely in kind" and covers six specific situations where gain is not recognized. The first relates to property held for productive use in trade or business, or for investment, which is exchanged solely for property of a like kind; the second, to exchange of common stock solely for common stock in the *same* corporation or preferred stock solely for preferred stock in the *same* corporation; the third, to exchange of stock or securities in a corporation solely for stock or securities in such corporation or in another corporation, a party to a reorganization, and in pursuance of a plan of reorganization; the fourth covers exchange of property by one corporation solely for stock or securities of another corporation, a party to a reorganization, and pursuant to a plan of reorganization; the fifth covers transfer of property to a corporation by one or more persons solely in exchange for stock or securities in such corporation; and the sixth covers receipt by a corporation of property distributed in complete liquidation of another corporation.

However, none of these sections is applicable to the present situation in the sense for which appellant contends. It did not involve an exchange of property held for productive use in trade or business or for investment for other property of a like kind. It was not an exchange of common or preferred stock for similar stock in the same corporation. It was not an exchange of stock of one corporation solely for stock in another corporation as provided in (b) (3). The nearest to being applicable might be (b) (4) covering an exchange

of property for stock or securities of another corporation, but there are several reasons why this section does not apply.

In the first place, the old company did not exchange its property for stock of the new company. That requirement would only be met by issuing the stock in the new corporation to the taxpayer company and not to the individual stockholders as was actually done.

In the next place, it must be done pursuant to a "plan of reorganization." Since there is no such plan the taxpayer would not be in a position to claim the benefit of the statute and, conversely, it could not be enforced against the taxpayer. Regulations 94, Articles 112(g)(2) and 112(g)(3). *Appeal of A. T. Evans*, 30 B.T.A. 746 at 752.

Finally, this subsection requires an exchange of property by one corporation *solely* for stock of another corporation. Here there was an additional consideration—an assumption of liabilities by the new company. For these reasons therefore—no exchange between one corporation and another, no plan of reorganization, and a substantial consideration other than receipt of stock—the steps taken fail to accord with the requirements of (b)(4).

The next subdivision applies only to transfers from one or more persons to a corporation in exchange for stock and is the familiar case of organization of a corporation and payment for its stock by turning in property. It is applicable so far as the last step in the transaction is concerned, namely, the formation of the new company and transfer to it by the individuals of

their interest in the property received in liquidation for the stock of the new company. It does not, however, by its terms apply to the transaction to which the appellant seeks to apply it, namely, the transfer by the old company of its property upon cancellation and surrender of its stock.

The sixth subdivision is obviously inapplicable because it relates only to liquidation of a controlled subsidiary corporation.

Even if the transaction satisfied the requirements of any of these sections in its technical aspects, it would still fail to be a tax free reorganization because of a lack of continuity of interest, in that the stockholders definitely received their respective undivided interests on liquidation and were free to retain the same and not go into the new corporation if they wished to do so. Had they bound themselves to turn in their property to the new organization the situation might be somewhat different, although even then it would fail to satisfy the technical reorganization requirements. But they were not obligated to do so nor was the new corporation obligated to accept payment of stock through the transfer of their property interests. Their subscriptions were in dollars and the new corporation could have insisted on the payment of dollars and not property had it seen fit to do so.

With regard to step transactions generally, see Paul and Mertens, Law of Federal Income Taxation, Vol. 2, p. 234, §17.110 and p. 235, §17.111, particularly examples (7), (11) and (14).

Another reason why the disallowance of the credit

was wrong is found in the regulations, under Section 27, respecting distributions in liquidation. In dealing with distributions which diminish earnings or profits, Section 19.27(g)-1 of Regulations 103 (1943 C.C.H. §372) corresponding with Article 27(f)-1 of Regulations 94, issued under the 1936 Act, provides that an allowance for dividends paid may be included in the basic surtax credit for the amount actually involved in such distribution as is properly chargeable to the earnings or profits accumulated after February 28, 1913, even though the method of taxation of the distribution is that ordinarily employed with respect to gain or loss realized and recognized upon an exchange rather than that employed with respect to a taxable dividend, but that this does not apply to a transaction which results in a transfer of such earnings or profits intact to another corporation in whose hands such earnings or profits, being available for distribution by it as dividends to its shareholders, have essentially the same status for the purposes of the law as earnings or profits derived from its own operations. In discussing the credit in respect of earnings or profits transferred under certain tax-free transactions, the Regulations provide:

> "If, as a result of one or more transactions described in Section 112, a corporation's earnings or profits accumulated after February 28, 1913, and its undistributed earnings or profits of the taxable year shall have become the earnings or profits of another corporation subject to distribution as dividends by such other corporation, any dividend paid by the transferee corporation during that portion of the transferor's taxable year

> subsequent to the consummation of such tax free transaction may, subject to the provisions of Section 115, be apportioned and allocated to the transferor as a distribution of such earnings or profits of the transferor." Reg. 103 §19.27(g)-1(c) 1943 C.C.H. §372.

In other words, under these rulings the credit is denied to the transferor in the case of such a transfer where the accumulated earnings or profits are available for distribution as dividends by the transferee. But that condition would not apply in this case because the assets transferred to the new company were received and applied as payment for its capital stock and could not constiute surplus or a fund from which dividends could be paid. Rem. Rev. Stat. §3803-24. See *Appeal of Reed Drug Company*, 44 B.T.A. No. 92.

While we repeat again that we do not believe that the question of whether the transfer of assets to and the issuance of stock by the new corporation constituted a tax free exchange under Sec. 112 (b) I.R.C. is material, we have discussed it because of appellant's insistence on the point and because consideration of the provisions of the section as applied to the facts of this case shows that even this argument is not well founded. The group of decisions of the Supreme Court of February 2, 1942, *Helvering v. Alabama Asphaltic Corp.*, 315 U.S. 179; *Helvering v. Palm Springs Holding Corp.*, 315 U.S. 185; *Helvering v. Marlborough House, Inc.*, 315 U.S. 189; *Helvering v. Southwest Consolidated Corp.*, 315 U.S. 194, decided while this case was under consideration and discussed by the trial court in his memorandum,

shows that the statute must cover literally and exactly the situation to which it is sought to apply it in order to produce a tax free or deferred result. Cf. *C. D. Johnson Lumber Co.* 47 B.T.A. 119.

The fact that the stockholders may have intended to go into the new company, in the absence of any obligation requiring them to convey their undivided interests to it, would not affect the situation. As was said in the appeal of *Harbor Holding Company* above cited:

> "When petitioner made the liquidating distribution of the Van Camp stock, each distributee was free to retain the stock, was free not to sell to the Phister group. As the matter stood on December 29, 1938, the offer of the Phister group had not been accepted, and, although it appears at that time the Phister group intended to buy the Van Camp stock and the individual distributees, except the Bonynges, intended to sell their respective shares, there remained still the interval within which everyone could have changed their minds. See *Estate of C. William Meinecke*, 47 B.T.A. 634, 639.
>
> "Under the above facts, it is concluded that certain former stockholders of petitioner, acting in their own right, voluntarily and without any obligation having been imposed upon them by petitioner, sold Van Camp stock to which they had title on December 30, 1938. It is not material that they consented to petitioner's dissolution in anticipation of their selling the property thereafter, which they would receive upon dissolution. It certainly was in the minds of the four stockholders of the Falcon Company that they anticipated selling the property they would receive in partial liquidation of Falcon at the

time they consented to the partial liquidation. On this point the facts here do not take this case outside the rule of the *Falcon* case."

CONCLUSION

To sum up, the position of the appellees is as follows:

The trial court was correct in determining that the trustees took and held the physical assets of the old company in trust for the stockholders and that there was a distribution of such assets to the stockholders followed by a transfer by or on behalf of the stockholders to the new corporation in exchange for its stock. There was therefore a liquidation of the old company and distribution of its assets wholly independent of the new company, thus supporting the dividend credit under Sec. 27 (f).

Even if the transaction amounted to a transfer of assets by the old company in exchange for issuance of stock to the stockholders of the old company, such transaction did not constitute a nontaxable distribution.

Finally, and in any event, whether the receipt of assets by the new company and issuance of its stock constituted a nontaxable transaction or not, there was a distribution in liquidation by the old company, for which it is entitled to a dividend credit under the plain terms of Sec. 27 (f). *Helvering v. Credit Alliance Corp., supra.*

Respectfully submitted,

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